SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1193

ST. FRANCIS HOSPITAL,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA AND BRIEF IN SUPPORT THEREOF.

SAMUEL GEORGE WAGNER,
EDWARD J. I. GANNON,
Counsel for Petitioner.

INDEX.

Subject Index.

	Page
Petition for writ of certiorari	1
Proceedings	1
(a) Board of Tax Appeals	1
(b) Court of Appeals	2
Summary statement of the matter involved	2
Jurisdiction	3
Question involved	3
Reasons for allowance of the writ	4
Prayer for writ	5
Brief in support of petition	6
Opinions below	6
Statement of jurisdiction	6
Statement of the case	7
Specification of error	8
Summary of argument	8
Argument	10
To whom was interest payable?	10
If the "Declaration of Trust" constituted an assignment	12
The interest payable to the Union Trust Company and actually paid to it in its own right or as fiduciary	15
The Act of Pennsylvania governing participation mortgages	17

Table of Cases Cited.

Bechman v. *Adams*, 36 District and County Rep. 479	16
Blair v. *Pennsylvania Company*, 24 District and County Rep. 490	19
Eldredge v. *Eldredge*, 194 Atl. Rep. 306, 128 Pa. Sup. 284	14
Gordon v. *Hartford Sterling Co.*, 179 Atl. Rep. 234, 319 Pa. 174	12
Guthrie's Estate, 182 Atl. Rep. 248, 320 Pa. 530	20
Oudry-Davis v. *Findley*, 64 Pa. Sup. 92	16
Vetter etc. v. *Meadville*, 236 Pa. 563, 85 Atl. 19	14

Statutes Cited.

	Page
Act of Pennsylvania, 1929, P. L. 512	17
Judicial Code, Sec. 240(a) (28 U. S. C. A. 347)	3, 6
Revenue Act of 1926, Sec. 1002(b), 1003(a) (44 Stat. 110) as amended by the Revenue Act of 1934, Section 519(a) (48 Stat. 760)	6
Revenue Act of 1928, Sec. 144 (45 Stat. 833)	8
Revenue Act of 1932, Sec. 143 (47 Stat. 215)	8
Vale's Pennsylvania Digest, Vol. 16, Section 153 (1939 Edition)	16

Other Authorities Cited.

Prentice-Hall Service, Vol. 2, page 18239, Section 18324	16

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1193

ST. FRANCIS HOSPITAL,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR REVIEW ON CERTIORARI OF THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

To the Honorable, The Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, St. Francis Hospital, a Pennsylvania corporation not for profit, of the City of Pittsburgh, Allegheny County, Pennsylvania, prays that a writ of certiorari may be issued to the United States Court of Appeals for the District of Columbia to review a decree of said court made and entered February 2, 1942, and respectfully submits the following:

Proceedings.

(a) *Board of Tax Appeals.*

In this case the Commissioner of Internal Revenue on February 20, 1939 determined that St. Francis Hospital

was subject to tax for the years 1930, 1931, 1932 and 1933 and made an assessment against said hospital which with penalty amounted to $3761.24. An appeal was taken to the United States Board of Tax Appeals May 17, 1939, and said Board entered judgment for the Commissioner October 25, 1940 (42 B. T. A. 1004).

(b) *Court of Appeals.*

January 2, 1941 a petition for review of said decision was filed in the United States Court of Appeals for the District of Columbia, as no returns had been filed by said St. Francis Hospital, and on February 2, 1942, the said Court of Appeals affirmed the order of the Board (125 F. 2d, 553).

Summary Statement of the Matter Involved.

The facts are set forth in a stipulation (R. 19-22), and are as follows:

St. Francis Hospital of Pittsburgh is a non profit Pennsylvania corporation engaged in charitable work of maintaining a hospital in the City of Pittsburgh. Its hospital buildings are encumbered by a mortgage to the Union Trust Company of Pittsburgh, a domestic corporation, in the sum of $1,100,000 accompanied by a single bond to said Trust Company, executed July 21, 1930, which mortgage includes the usual provision for the payment of interest without deduction of Federal income tax up to 2%.

Subsequent to the delivery of the mortgage about August 21, 1930, the Union Trust Company, without any notice to or knowledge on the part of St. Francis Hospital, executed and retained in its records a "Declaration" that the said mortgage and bond were "held in trust for the several estates interested therein to the extent of the contribution of each of said trust estates toward the principal thereof

as shown by the books" of the company (R. 23); without specifying any particular estates and without any record of said "Declaration" in the Recorder's Office of the proper county.

Each semi-annual installment of interest in accordance with the provisions of the mortgage and bond was paid by the hospital in a single check to the Union Trust Company. The Union Trust Company allocated on its books to the various estates such portions of the interest payments as were applicable to such estates; and thereafter sent to the hospital Treasury Form No. 1000, known as "Ownership Certificate" for each estate, showing the amount of such interest.

Jurisdiction.

Petitioner prays the Supreme Court to exercise its jurisdiction under Section 240 (a) of the Judicial Code (28 U. S. C. A. 347; 43 Stat. 938).

The Question Involved.

Is the petitioner liable as "withholding agent" for income tax upon the payment of interest on a single bond and mortgage to a domestic corporation under the Revenue Act requiring withholding where the interest is "*payable to* an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein", because the mortgagee, as corporate fiduciary, without notice to or consent of the mortgagor, allocated merely by notation on its books portions of the said mortgage and bond to various estates, the interest being paid to the mortgagee in accordance with the mortgage and bond without any recognition by the mortgagor of such allocation?

The Reasons for Allowance of the Writ.

Your petitioner avers that the United States Court of Appeals for the District of Columbia in this case has decided erroneously a question of general importance to the persons and corporations who have executed mortgages with bonds accompanying the same; and that it involves a question of substance relating to the construction of the statute of the United States covering the withholding of tax, which has not been, but should be, settled by this Court.

It is conceded by the Commissioner and by the Court below that, under the bond and mortgage as executed, petitioner would not have been required to pay any tax. Because the Trust Company subsequently allocated portions of the mortgage on its books to various estates, the funds of which were from time to time invested therein, the Court of Appeals nevertheless held that petitioner became liable for the payment of such tax, notwithstanding the fact that the interest was still "payable to" the fiduciary, Union Trust Company, a domestic corporation; that the mortgagee, even if it were not a fiduciary, had no right to divide this obligation into numerous parts; and that your petitioner was not bound by any partial assignments thereof, but only in the case of a single assignment of the whole obligation as set forth in the rulings quoted in the supporting brief, filed herewith.

The decision of the Court of Appeals also disregarded the statute of Pennsylvania, the only authorization for holding of a mortgage by a fiduciary, such as the Union Trust Company, and the allocation of participations therein among trust estates. This statute, which is quoted in the supporting brief, specifically provides that no estate "participating shall be deemed to have individual ownership in any bond and mortgage", and that the fiduciary shall

have the right at any time to take back "any such bonds and mortgages from such fund, with the right to substitute therefor other bonds and mortgages." Under this statute the interest on such "pool" mortgage "is payable" only to the fiduciary, and the participating estates have no "ownership" therein or right to collect the same.

It is petitioner's position that under the bond and mortgage as originally prepared, there was no obligation on it under the income tax provisions as withholding agent and no such payment was contemplated by the parties; and there could be no liability except in the remote contingency of an assignment of the entire mortgage of $1,100,000 to an individual, a partnership or a foreign corporation. This is not a case of a severable bond issue, or a mortgage or deed of trust to secure an issue of numerous bonds, but of a single bond accompanying a single mortgage.

The question presented here is vital to the continued operation of this charitable institution; and the proper construction of this statute is of such general interest and substantial importance that it should be settled by your Honorable Court.

Your petitioner makes a part of this petition the record in the Court of Appeals for the District of Columbia and the brief in support of this petition.

WHEREFORE, your petitioner respectfully prays that the court will grant a writ of certiorari directed to the Court of Appeals for the District of Columbia to the end that this case may be reviewed and determined by this Court; and that petitioner may have such other and further relief as to the Court may seem proper.

SAMUEL GEORGE WAGNER,
EDW. J. I. GANNON,
Attorneys for St. Francis Hospital.

BRIEF FOR PETITIONER.

Opinions Below.

The Commissioner of Internal Revenue on February 20, 1939, determined that petitioner was subject to tax for the years 1930, 1931, 1932 and 1933 amounting to $3,008.99 and made an additional assessment against said hospital in said amount, and penalty of $752.25.

The opinion and decision of the Court of Appeals for the District of Columbia is reported in 125 Federal Reporter, Second Series, page 553.

Statement of Jurisdiction.

The case is presented to this Court on petition for writ of certiorari to review a decision of the United States Court of Appeals for the District of Columbia under Section 240 (a) of the Judicial Code (28 U. S. C. A. 347; 45 Stat. 938).

The Commissioner of Internal Revenue on February 20, 1939, determined that petitioner was subject to tax for the years 1930, 1931, 1932 and 1933 amounting to $3,008.99 and made an additional assessment against said hosiptal in said amount, and penalty of $752.25.

An appeal was taken to the Board of Tax Appeals May 17, 1939 (R. 3) under Section 272 of the Revenue Act of 1928 and 1932 and upon hearing, a judgment was entered for the Commissioner on October 25, 1940 (R. 16). January 2, 1941 a petition for review of said decision was filed in the United States Court of Appeals for the District of Columbia (R. 17) under the Revenue Act of 1926, Section 1002 (b), 1003 (a) (44 Stat. 110) as amended by the Revenue Act of 1934, Section 519 (a) (48 Stat. 760). The court affirmed the Order of the Board of Tax Appeals February 2, 1942.

Statement of the Case.

St. Francis Hospital was indebted to the Union Trust Company on a mortgage and single bond accompanying the same executed by the Sisters of the Third Order of St. Francis and assumed by St. Francis Hospital. The mortgage contained the usual covenant to pay interest without deduction of income tax up to 2%; and each semi-annual installment of interest was paid in a single check to said trust company (R. 21).

After the delivery of the mortgage and bond to the trust company, said trust company executed and retained in its files a "Declaration of Trust" (R. 23) wherein it certified that the "mortgage and its accompanying bond, and all moneys secured thereby, are held in trust for the several estates interested therein to the extent of the contribution of each of said trust estates towards the principal thereof, as shown by the books of original entry, ledgers, vouchers, cards and other records of the trust department pertaining thereto." This "Declaration of Trust" was not recorded, and no notice thereof was given to petitioner.

As the trust company had available funds of various estates for which it was fiduciary, portions of the said mortgage and bond were allocated on the books of the trust company to such various estates "for which it was guardian, trustee, agent or other fiduciary, by notation upon its records that said funds of these estates were invested in said mortgage" (R. 21).

After the interest had been paid to the Union Trust Company, it distributed on its books among these estates such portions of the interest payment as were applicable to such estates by reason of the allocation of their funds to said mortgage.

The Union Trust Company is a domestic corporation (R. 22).

Section 144 of the Revenue Act of 1928 (45 Stat. 833) and Section 143 of the Revenue Act of 1932 (47 Stat. 215) are in part as follows:

"Sec. 144. WITHHOLDING OF TAX AT SOURCE.

(a) Tax-free covenant bonds.—

(1) REQUIREMENT OF WITHHOLDING.—In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein."

Specification of Error by the United States Court of Appeals for the District of Columbia.

The said Court of Appeals erred in affirming the order of the Board of Tax Appeals and entering judgment in favor of the Commissioner of Internal Revenue at No. 7829, for the reason that the interest on the bond and mortgage in this case was payable to a domestic corporation, and St. Francis Hospital was not required to withhold any portion of the same, or pay any tax on account of such interest.

Summary of Argument.

It is conceded that the loan in this case was by the Union Trust Company originally and that under the bond and mortgage the interest was payable to a domestic corpora-

tion and no "withholding" required. The decision of the Court is based upon a "Declaration of Trust" executed by the mortgagee subsequent to the original mortgage setting forth that the mortgage was held in trust for several estates interested therein to the extent of the contribution of each toward the principal thereof as shown by the books of the trust company. This declaration does not specify any estates or any amounts. Even if the "Declaration of Trust" could be considered as an assignment, as it would involve the splitting up of the mortgage into numerous small amounts for numerous assignees, it would not be valid as against the mortgagor without the consent of the mortgagor, and the interest and principal would still be payable in one sum to the mortgagee.

However, the Declaration of Trust is simply a statement that the funds of various estates for which the trust company is fiduciary are from time to time invested in said mortgage as a mortgage pool, no part thereof being held except by the trust company in its own right and the trust company as fiduciary for such estates. As such fiduciary it alone would have the right to collect the interest and principal and the beneficiaries or other persons interested in said various estates would have no right to collect either the interest or principal and the interest would still be "payable to" the Union Trust Company.

The holding or the investment of funds of estates by fiduciaries in a pool mortgage or mortgages is governed by the Pennsylvania Act of 1929 which provides that no estate shall have any ownership in any such bond or mortgage and that the trust company shall have a right to retake any bonds or mortgages from the pool and to substitute other bonds and mortgages therefor. Under this act even the various estates have no interest in any such mortgage and of course, the individuals to whom such estate may be ultimately distributed would have no such interest, the right

of any estate in such pool mortgage being the right to participate pro rata with the other estates in the income and ultimately in the liquidation of the principal.

The interest involved here therefore was payable only to the original mortgagee. No other person had any right to proceed for the collection of the same and no other payment would have been possible either as a matter of law or as a matter of practical business dealing.

ARGUMENT.

An examination of the Act relating to "withholding" shows that it provides for such withholding where such interest is "*payable to* an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States and not having an office or place of business therein." As the Union Trust Company is a domestic corporation and has an office in Pittsburgh, Pennsylvania, it is evident that this legislation does not apply. Even in the case of a foreign corporation if it has an office in the United States or is engaged in business here no withholding is required. The evident intent was that in the case of a domestic corporation or a foreign corporation having an office or place of business here, the Internal Revenue Department could deal with such corporation without any difficulty; and that any withholding from interest or other sums due such corporations was not necessary to insure the collection of tax, and would impose an unnecessary burden upon the person paying the same.

To Whom Was Interest Payable?

The real question is: *To whom was the interest payable?* It will be noted that this is not a bond issue, but a single bond accompanied by a mortgage given for a loan made by the Union Trust Company to the hospital.

Under the admitted facts in this case the interest was "payable to" the Union Trust Company. It sent out the usual notice as to the payment of the interest semi-annually, and the interest was actually paid to it. No assignment or transfer of the mortgage was made; no notice was ever given to St. Francis Hospital that the mortgage was held other than by the Union Trust Company; and accordingly it was *payable to* and actually paid to a domestic corporation. Under the facts as set forth in the stipulation, it would have been impossible for the hospital to have paid the interest in any other way. If the hospital had actual notice of the so-called "Declaration of Trust" it could not have made distribution of the interest among the various estates. The "Declaration of Trust" does not specify any of them or indicate the extent to which the funds of said estates had been invested in the principal of said mortgage; even if we did not have the important circumstance that in all cases they were "the several estates" for which the Union Trust Company was fiduciary. The investments of the various estates change from time to time, as a minor became of age, or funds are necessary for his education; or under a trust various amounts became payable to various beneficiaries; so that the estates participating in the income from this mortgage were changing frequently, and possibly even from day to day.

However, the real question is—*To Whom was the interest "payable"*? Congress did not impose on the payer of the interest the duty of deciding the ultimate beneficiary, or the person who might have an equitable, remote or contingent estate. It knew that for his own protection, the obligor or mortgagor would have to determine the person to whom the interest was legally payable; and it made this simple fact the test of his liability to withhold the tax thereon. The same phraseology is used in the Act as to an

obligor *with no covenant* as in the present situation when we have such a covenant. Even in the present case the petitioner's covenant is limited to 2% and in the case of a foreign corporation the withholding required is 12%. Obviously it is necessary for the protection of the obligor that he know the amount to be withheld *at or before the time of payment.* Information as to any equitable or other interest in the obligation acquired *after* the payment had been made would be useless, and accordingly Congress fixed the test as the time of payment and the person to whom the interest was payable.

If the "Declaration of Trust" Constituted an Assignment.

It is the position of the hospital here that even if the so-called "Declaration of Trust" constituted an assignment of various interests or shares in the mortgage to the various estates designated upon the books of the trust company, it did not change the status of the parties here and the interest would still be "payable to" the Union Trust Company. It is conceded that the mortgage here was subject to assignment as a whole to one particular assignee, but the Union Trust Company as mortgagee had no right to split it up into numerous fragments and transfer title to these fragments to numerous estates or individuals so that an obligation would be imposed upon the hospital to pay the pro rata amount of interest to each of these numerous assignees. In the present case, for instance, there were in excess of 100 different estates which participated in this mortgage in varying amounts at various times. The rule as to this is well established in Pennsylvania. The question was before the Supreme Court of Pennsylvania, in the case of *Gordon, Secretary of Banking* v. *Hartford Sterling Company, et al.,* 319 Pa. 174, 179 Atl. Rep. 234, decided

May 27, 1935. In this case the Supreme Court held as set forth in 179 Atl. Rep. at page 236:

> "The assignment was for a part of the claim recoverable under the insurance policies. It was a partial assignment. We have early held that partial assignments are not binding unless they have been assented to by the debtor. Jermyn *v.* Moffitt, 75 Pa. 399; Philadelphia's Appeal, 86 Pa. 179; Geist's Appeal, 104 Pa. 351; Vetter *v.* Meadville, 236 Pa. 563, 567, 85 A. 19; Wells *v.* Philadelphia, 270 Pa. 42, 112 A. 867. The reason advanced is that a creditor should not be permitted to split up a single cause of action into many without the assent of the debtor; to do so subjects the debtor to embarrassments, responsibilities, and multiplicity of suits not contemplated in his original undertaking. It was held in Jermyn *v.* Moffitt, supra, that the assignment of part of a debt will not bind the debtor, either in equity or at law, nor deprive him of the right to pay the whole to the assignor, even after notice that a part has been transferred to the assignee. This latter principle was emphasized in Geist's Appeal, supra, where an attempt was made, through partial assignments, to lay hold of a fund held by the city of Pittsburgh for one of its creditors. The creditor made an assignment for the benefit for creditors; his assignee disregarded the claims of the partial assignees and collected the debt from the city; we held that the partial assignments did not bind the fund or any part of it. Therefore, where an assignor assigns a part of his claim, he is still the principal creditor and retains control of the claim unless the debtor accepts the assignee as a new creditor to the amount of the assignment."

One of the "embarrassments and responsibilities" which would result to the debtor from assignments of parts of the mortgage is the possible liability for income tax which is being asserted in this proceeding by the Commissioner of Internal Revenue.

The same question was before the Supreme Court of Pennsylvania in the case of *Vetter for use of Pittsburgh Buffalo Company* v. *Meadville,* 236 Pa. 563; 85 Atl. 19, where a partial assignment of a claim against the city of Meadville had been made and assented to by the City Treasurer. The Court held that the consent of the City Treasurer to the assignment was not binding upon the city and therefore the partial assignment could not be enforced against the city. The syllabus of the case as set forth at 236 Pa. 563 is as follows:

> "No suit can be maintained on a partial assignment of a debt unless it appears that the debtor assented to the assignment.
>
> An assignment by a city contractor of a portion of his claim against the city, and the assent to the assignment by the city treasurer, cannot be made a basis of an action against the city, unless it appears by the plaintiff's case that the city treasurer had authority to assent to the assignment on behalf of the city. No such authority is implied from his office."

The question of the application of this principle to a mortgage was before the Superior Court of Pennsylvania in the case of *Eldredge* v. *Eldredge, et al.,* 128 Pa. Superior 284; 194 Atl. Rep. 306.

The Superior Court said as set forth in 194 Atl. Rep., 310:

> "Complainant sought to have an award made from a 5/18 interest in a mortgage which her husband inherited from his parents * * * The mortgagors unless they have consented to do so, cannot be compelled to pay the mortgage debt in fractional shares to a number of people to whom the mortgage was not originally given. Concrete Form Co. *v.* W. T. Grange Construction Co., 320 Pa., 205, 208; 181 A. 589; Gordon *v.* Hartford Sterling Co., 319 Pa. 174, 177, 178, 179 A. 234, and cases cited therein."

Under the ruling in these cases it is apparent that without the express consent of the hospital it could not be required by any assignment or other act of the Union Trust Company to pay either the principal or interest of this mortgage in numerous parts to numerous assignees of portions thereof, and accordingly that whatever may be the effect of the so-called "Declaration of Trust" in this case, it would not change the legal status of the hospital; and so far as the hospital was concerned, the interest on the mortgage was still "payable to" the Union Trust Company.

The Interest Payable to the Union Trust Company and Actually Paid to It in Its Own Right or as Fiduciary.

It is the contention of the Commissioner, however, that because of the "Declaration of Trust", the estates acquired such rights in the mortgage that the various portions of interest thereon were "payable to" such various estates. Under the income tax legislation a fiduciary is treated as a tax payer representing the particular estate.

Under the stipulation of facts in this case, and the so-called "Declaration of Trust", Exhibit A, the Union Trust Company was *fiduciary* and the bond and mortgage held by it "in trust for the several estates interested therein to the extent of the contribution of each of said trust estates towards the principal thereof", so that there can be no question about the fiduciary character of the holding by the Union Trust Company for any portions of the bond and mortgage, which it did not hold in its own right.

As such fiduciary the Union Trust Company was under the obligation to make a return and subject to all the provisions of the law applicable to individuals. The income tax legislation very properly considers the fiduciary as the legal receiver of income accruing to an estate under its charge and control; and not the ultimate beneficiaries,

who may or may not receive the income depending upon the expenditures for administration, the claims of creditors, or other matters which may properly come before the courts on the final distribution. This is in accordance with the rulings of the courts as to the rights, powers and duties of fiduciaries. Under the Pennsylvania law, (and it is a principle of universal application), as it is set forth in Vale's Pennsylvania Digest, Vol. 16, Section 153, (1939 Edition), "The title to personal property of a decedent vests in the personal representative until distributed."

In a recent case before the Court of Common Pleas of Schuylkill County, Penna., *Bechman, Secretary of Banking* v. *Adams,* and reported in 36 District & County Reports, page 479, where a certificate for 8 shares of a bank's stock was issued to "Thomas N. Haesler, Guardian for Marvin L. Adams", it was held that after the minor had come of age he was not liable for an assessment made against the stock of the bank for the reason *that the title thereto did not vest in him until the certificate was actually endorsed and delivered or a separate assignment thereof executed.*

Likewise in the case of *Oudry-Davis* v. *Findley,* 64 Penna. Superior Court, 92, the Superior Court said, page 94:

> "It is a well recognized rule that debts due a decedent must be collected by his personal representatives. no one else unless in exceptional cases has any right to bring suit and enforce payment."

This situation is summed up in the Prentice-Hall Service, Vol. 2, page 18239, Section 18324, as follows:

> "The application of the withholding provisions of the statute to the income of a trust depends on the status of the fiduciary and not the creator or the beneficiaries thereof."

It is apparent, therefore, that even where a mortgage is held by a fiduciary expressly for a particular estate, the ultimate beneficiaries have no direct interest in the mortgage or any control over the disposition or collection of the same. The fiduciary alone has the right to collect it, to sell it, to bring suit and to enter satisfaction when it has been paid, *and it is payable only to the fiduciary.* The action of the fiduciary in any of these matters protects the person paying; the ultimate beneficiaries cannot interfere with it, and have no right except to proceed against the fiduciary for any negligence in the performance of these various duties. Therefore, even if this mortgage had been held by the Union Trust Company as guardian, executor or trustee in a particular estate, the interest still would be "payable to" the Union Trust Company, a domestic corporation, and no other payment would protect the hospital under its bond and mortgage.

The Act of Pennsylvania Governing Participation Mortgages.

However, in this case it was not held by the Trust Company as Trustee for any designated estate. It simply represented an investment pool which was used for the funds in numerous estates, both the estates and the mortgages therein changing from time to time and representing a sort of revolving fund both as to the estates and as to mortgage investments. It is an arrangement made in pursuance of the Act of Assembly of Pennsylvania which has been amended from time to time, the particular Act in force at the time the mortgage and so-called "Declaration of Trust" were executed being the Act of April 11, 1929, P. L. 512, which provides in substance that trust companies shall keep all trust funds separate and apart,

> "And provided further, That said companies may assign to their various trust estates participation in a

> general trust fund of mortgages upon real estate securing bonds, in which case it shall be a sufficient compliance with the provisions of this section for the company to designate clearly on its records the bonds and mortgages composing such general trust fund, the names of the trust estates participating therein, and the amounts of the respective participations; and in such cases *no estate so participating shall be deemed to have individual ownership in any bond* and mortgage in such fund, and the company shall have the right at any time to *repurchase at market value but not less than face value any such bonds and mortgages from such fund,* with the right to *substitute therefor other bonds and mortgages.*"

The act uses the word "assign", but it is not intended in the sense of a transfer of title, but rather as the designation or setting apart of a particular thing. The dictionary, in addition to the meaning of a transfer, specifies other definitions as follows, "to allot—to designate or appoint for a particular purpose—to fix or specify." The word "assign" could not have been used in the sense of "transfer" because the Act provides, "No estate so participating shall be deemed to have individual ownership in any bond and mortgage in such fund", followed by the further provision that the trust company shall have the right to repurchase any mortgage "from such fund" and also the right "to substitute therefor other bonds and mortgages." It is obvious that the trust company in this case did what the Act of Assembly contemplated—designated or allocated portions of this mortgage as representing for the time being investments of various estates for which it was fiduciary. Under the express phraseology of the Act, however, "no estate so participating shall be deemed to have individual ownership" and the trust company retained the legal right to take back any portion of the mortgage or to "substitute" other bonds and mortgages therefor. These provisions are entirely in-

consistent with the vesting of any title in the various estates.

Under this legislation the Trust Company is treated as owning and controlling the mortgage or mortgages in the fund or mortgage pool, and the various estates as having no interest whatever therein, but only an equitable participation in the entire pool to the extent of the temporary investment of funds. No estate has any ownership in any bond or mortgage, as the Act specifically states, and the "right to repurchase" under the Act is not to repurchase from any estate or estates, but "From such fund" or mortgage pool. The trust company has also the right to remove any mortgages from the pool and substitute other mortgages therefor, dealing only with its trust department, which owns and controls the pool and not with the estates which may be "participating therein." Accordingly, it is apparent that no estate which may be participating in the mortgage pool or fund has even an equitable interest in any mortgage therein. Its rights are even less than those of a stockholder of a corporation who, of course, has no particular interest in any specific asset of the corporation, the title to such assets being in the corporation itself; and no one would suggest for a moment that a person paying interest to a domestic corporation would come under the provisions of the "withholding" legislation because some of the stockholders of that corporation were individuals or partnerships. The effect of this law of Pennsylvania was before the Court of Common Pleas of Philadelphia County, Pennsylvania in *Blair* v. *Pennsylvania Company, etc.*, 24 District and County Reports, 490. Defendant had held a mortgage for four estates of which it was fiduciary, foreclosed the mortgage and purchased the property as Trustee. The plaintiff, who was a beneficiary in one of said estates, filed a bill in equity to compel partition on the theory that he had an interest in this mortgage, and therefore an interest in the real estate, which was the result of a foreclosure of the mortgage. The

court held that notwithstanding the fact that there was in the case a single mortgage, it came within the provisions of the legislation cited above, and the court said:

> "One of the purposes of the act was to segregate control of the mortgage from the beneficiaries and impose on the trustee the duty to protect the former's investment. The act specifically states that the cestuis que trustent shall have no individual ownership in the bond and mortgage and it necessarily follows that on foreclosure this separation of legal and beneficial interest continues until the property has been liquidated. To hold that the trust ceases on the foreclosure of the mortgage would be to defeat the purposes of the act which gives the trustee the entire control in the handling of this particular investment. The act, in effect, authorizes the creation of a special trust which cannot be held executed until its purposes are accomplished."

A similar question was before the Supreme Court of Pennsylvania in *Guthrie's Estate*, 320 Pa., 530, 182 Atl. Rep. 248, where the question was raised that as there was only a single mortgage, it did not come within the Act of 1925, amended in 1929, which we have heretofore set forth in this brief. The Supreme Court in its opinion as set forth in 182 Atl. Rep., 250, said:

> "It is plain that the Legislature saw fit to permit an exception to the rule in the case of participation in a pool of a number of mortgages because such pools could not be successfully operated otherwise. It is equally plain that the exception is no less necessary to the successful operation of participations in single mortgages, and that the legislative intention must therefore have been to include the latter within the exception. The distinction is between mortgages in which participation is allotted and those in which there is no participation. The single mortgage participation scheme is generically not distinguishable from that in which the participation is in a larger pool."

It is apparent therefore, that whether the mortgage in this case constituted a single pool, or was part of a pool composed of several mortgages, is immaterial. The effect of the legislation is exactly the same. It is also apparent that no estate which may at any time have had participation in this mortgage acquired any ownership therein; that the title to said mortgage remained at all times in the Union Trust Company with the absolute control thereof, with the right to take it back from the trust department pool into the commercial or individual ownership of the bank and with the right to substitute other mortgages therefor. Accordingly, there seems to be no doubt that the interest in this case was "payable to" the Union Trust Company, a domestic corporation and that the "withholding" legislation does not apply.

Respectfully submitted,

SAMUEL G. WAGNER,
EDWARD J. I. GANNON,
Attorneys for St. Francis Hospital.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	2
Argument	4
Conclusion	9
Appendix	10

CITATIONS

Cases:	
Blair v. *Pennsylvania Co.*, 24 D. & C. (Pa.) 490	9
Brewster v. *Gage*, 280 U. S. 327	6
Burnet v. *Hormel*, 287 U. S. 103	9
Morgan, *Commissioner*, 309 U. S. 78	9
National Lead Co. v. *United States*, 252 U. S. 140	6
Guthrie's Estate, 320 Pa. 530	9
Statutes:	
Act of April 11, 1929, P. L. 216, Laws of Pennsylvania (1929) p. 512	8
Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 221	5
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 221	5
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 221	5
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 221	5
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 144	7, 10
Sec. 162	6
Sec. 291	11
Revenue Act of 1932, c. 209, 47 Stat 169:	
Sec. 143	12
Sec. 161	7
Sec. 291	12
Miscellaneous:	
I. T. 2605, X-2 Cum. Bull. 192 (1931)	5
5 Paul & Mertens, *Law of Federal Income Taxation*, Sec. 49.04	4
1940 Prentice-Hall Tax Service, vol. 2, p. 18,239, Sec. 18,324	5
Treasury Regulations 45, Secs. 363-369, 374	5
Treasury Regulations 77, Secs. 761, 763-769	5, 14

462486—42——1

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1193

ST. FRANCIS HOSPITAL, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 6–16) is reported in 42 B. T. A. 1004. The opinion of the Court of Appeals (R. 24–29) is reported in 125 F. (2d) 553.

JURISDICTION

The judgment of the Court of Appeals was entered February 2, 1942 (R. 30). The petition for a writ of certiorari was filed April 23, 1942 (R. 30).

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The withholding provisions of Section 144 of the Revenue Act of 1928, and Section 143 of the Revenue Act of 1932 are applicable to interest paid to individuals but not to interest paid to domestic corporations. The question presented is whether interest on a mortgage obligation paid to a domestic corporation as trustee and then distributed to participating beneficiaries is to be regarded as paid to the trustee or to the cestuis.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra,* pp. 10–16.

STATEMENT

In July 1930 the taxpayer's predecessor,[1] the Sisters of the Third Order of Saint Francis, executed a mortgage for $1,100,000 to The Union Trust Company of Pittsburgh, a domestic corporation (R. 20, 22). The mortgage contained the common tax-free covenant whereby the taxpayer agreed to pay interest without deduction for income tax which it might be required to withhold to the ex-

[1] The debt was subsequently assumed by taxpayer (R. 21). The mortgage debt was always considered the debt of taxpayer, which made all interest payments thereon (R. 21).

tent of a tax of two percent, and to pay on behalf of the creditor income tax to the extent of two percent (R. 20). Shortly after the delivery of the mortgage The Union Trust Company of Pittsburgh executed and retained in its own files a "Declaration of Trust" which stated that the mortgage and mortgage bond were held in trust for the several estates interested to the extent of their contribution toward the principal (R. 21, 23, Ex. A). The Union Trust Company of Pittsburgh did not at that time notify the taxpayer that such a declaration of trust had been executed (R. 21). The semi-annual interest instalments were paid by the taxpayer to The Union Trust Company of Pittsburgh by a single check (R. 21). As these instalments were paid, the Trust Company distributed the interest among the participating estates and forwarded to the taxpayer ownership certificates (Treasury Form 1000) showing the payments to the several estates (R. 22).

The Commissioner determined that the taxpayer was required by Section 144 of the Revenue Act of 1928 and Section 143 of the Revenue Act of 1932 to pay withholding taxes upon the interest paid and asserted a deficiency for the years 1930, 1931, 1932, and 1933 in the amount of $3,008.99 in tax and a penalty of $752.25 (R. 3). The Board of Tax Appeals affirmed the Commissioner's determination (R. 6–16), holding that payments were made to the beneficiary estates and not to the trust company,

a domestic corporation. The Court of Appeals affirmed (R. 24–29).

ARGUMENT

The applicable sections of the Revenue Acts of 1928 and 1932 require that when a bond or mortgage contains a provision that the debtor will pay any portion of the tax imposed upon the creditor, the debtor shall withhold a tax equal to two percent of the interest, provided that the interest is payable to an individual, partnership, or foreign corporation, but not to a domestic corporation.[2] In the instant case, payment was made to The Union Trust Company, a domestic corporation, which then distributed the interest among the various participating estates. The question is whether, within the meaning of the Act, the payee was the trustee corporation, as holder of the legal title, or the cestuis as owners of the beneficial interest. If the payment is not deemed to have been made to the domestic corporation, the Act is applicable.

1. It is our position that interest is payable to a domestic corporation within the meaning of the Revenue Acts only when it is received by the corporation as its own taxable income and not when it is received by the corporation as agent or trustee

[2] The use of the word "withhold" in this section is somewhat misleading. When the mortgage contains a tax-free covenant, the practical effect of the statute is to require the debtor to pay the full amount of interest contracted for and to pay to the Government a tax amounting to two percent of the interest. See 5 Paul & Mertens, *Law of Federal Income Taxation*, Sec. 49.04.

for individuals or participating estates. The recipient of the interest for purposes of the withholding provisions is necessarily the person who would otherwise be taxed upon the interest as income. He is the payee although the interest may be collected by an agent or trustee on his behalf. The object of the withholding feature of the Revenue Acts was to permit creditors or bondholders who had bargained therefor to transfer a portion of their tax burden to their debtors or obligors. This statutory advantage should be available to all bond or mortgage holders, irrespective of whether, as is often the case, they receive interest through a corporate trustee as intermediary.

Similar provisions in Revenue Acts since 1918 [3] have been consistently interpreted by the Treasury as dependent for their application upon the status of the person who would be taxed on the interest received and not upon that of the intermediary.[4]

---

[3] Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 221; Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 221; Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 221; Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 221.

[4] This has been the Treasury practice. See Articles 363 through 369 and Article 374 of Regulations 45, promulgated under the Revenue Act of 1918; Articles 763 through 769 of Regulations 77, promulgated under the Revenue Act of 1932. Intervening regulations are to a similar effect.

The taxpayer places reliance upon a statement found in the 1940 Prentice-Hall Tax Service, Vol. 2, p. 18,239, Sec. 18.324, to the effect that the application of withholding provisions to trusts depends upon the status of the fiduciary and not that of the grantor or beneficiary. This statement is derived from I. T. 2605, X–2, Cum. Bull. 192 (1931),

This long continued administrative interpretation, during a period in which the law has been repeatedly reenacted, is entitled to great weight. *Brewster* v. *Gage*, 280 U. S. 327; *National Lead Co.* v. *United States*, 252 U. S. 140.

The fact that the mortgage provided that interest should be paid to the Union Trust Company is immaterial. Mortgages frequently provide that interest is to be paid to a corporate collecting agent which has no interest in the obligation and which acts as a mere conduit between the debtor and its creditors. The Trust Company did not receive the interest in its own behalf; it was under a duty to pay over the interest to the estates in accordance with their contribution to the principal of the loan.

The taxpayer argues (pp. 15–17) that since the interest was paid to the Trust Company as fiduciary for the individual estates and since it was required to make an income tax return on behalf of the estates, the interest was "payable to" a domestic corporation within the meaning of the Revenue Acts. This overlooks the facts that the Trust Company received the income only in a representative capacity and that when it made income tax returns on behalf of the estates, which are entities taxed as individuals (Section 162 of the Revenue

---

which was concerned with a different withholding provision (I. R. C. Sec. 143 (b)) relating to nonresident aliens. The object of such a provision is to prevent aliens from evading a tax. Since the purpose of permitting withholding in the case of tax-free covenant bonds is entirely different the ruling with respect to aliens is clearly inapplicable.

Act of 1928 and Section 161 of the Revenue Act of 1932), it returned the interest as their, not its own, income. For tax purposes, the estates, not the Trust Company, are the owners of the obligation.

The taxpayer also argues (p. 11) that Congress did not intend to impose upon the obligor the duty of determining the identity of the beneficiary, and that, accordingly, the status of the trustee-payee must control. But the statute contains an express provision for situations in which the owner of the obligation was unknown to the obligor; the obligor is then given an opportunity to protect himself by deducting an additional percentage of the interest.[5] In any event, the taxpayer here knew the names of the owners of the obligations from the ownership certificates forwarded to it (R. 22).

2. The taxpayer urges (pp. 12-15, 17–21) that the Court of Appeals erred, (a) in that it failed to give force to the rule against splitting a cause of action without the consent of the obligor, and (b) in that it refused to give effect to the provisions of a Pennsylvania statute concerning the pooling and allocation of mortgages by trust companies. The rule

---

[5] The last proviso in Sec. 144 (a) of the 1928 Act (see Appendix, *infra*, p. 11) reads as follows:

"* * * *Provided further*, That if the owners of such obligations are not known to the withholding agent the Commissioner may authorize such deduction and withholding to be at the rate of 2 per centum, or, if the liability assumed by the obligor does not exceed 2 per centum of the interest, then at the rate of 5 per centum."

162486—42——2

against splitting a cause of action prevented the Trust Company from assigning to the participating estates the right to receive interest directly from the debtor or to take legal action to collect interest and principal. This rule does not prevent the assignment of the beneficial interest to the participating estates, but merely protects the obligor against a multiplicity of demands and suits. The Trust Company continued to exercise the powers of collection, but as trustee for the true owners, the participating estates, not in its own behalf. The ordinary corporate bondholder has no unlimited right to sue for interest or to collect principal on his own behalf but must rely upon the mortgage trustee to protect his interests. He is, none the less, considered the owner.

The Pennsylvania statute, Act of April 11, 1929, P. L. 216, Laws of Pennsylvania (1929), p. 512, allegedly disregarded, allowed trust companies to pool mortgages held by them and to allocate to the trust estates undivided interests in the pool; it provided that no participating estate should be deemed to have individual ownership of any mortgage in the pool; and it allowed trust companies to buy mortgages from the pool at market value and substitute other mortgages therefor. The purpose of the limitation upon "individual ownership" and the other provisions of the Pennsylvania statute was to allow trust companies to manage estates efficiently by pooling arrangements and to give the trust companies a greater flexibility

in management than they might otherwise have had. *Guthrie's Estate,* 320 Pa. 530; *Blair* v. *Pennsylvania Co.,* 24 D. & C. (Pa.) 490. But it was recognized that the Act involved merely the separation of the "legal and beneficial interest" (*Blair* v. *Pennsylvania Co., supra,* at 493–494); it deprived the cestui of some powers of management, but not of his right to the proceeds of the interest. The statute does not purport to vest in trust companies, which have allocated interests in mortgages to trust estates, the right to receive interest on the mortgage loans as their own corporate income.

In any event, the peculiar nomenclature assigned by state law to given rights or types of ownership does not govern the application of the revenue laws if Congress intended to tax these rights or types of ownership. *Morgan* v. *Commissioner,* 309 U. S. 78; *Burnet* v. *Harmel,* 287 U. S. 103.

CONCLUSION

The decision below is correct. There is no conflict of decisions. No question worthy of review is presented. It is respectfully submitted, therefore, that the petition should be denied.

CHARLES FAHY,
Solicitor General.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
CAROLYN E. AGGER,
Special Assistants to the Attorney General.

MAY 1942.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 144. WITHHOLDING OF TAX AT SOURCE.

(a) *Tax-free covenant bonds.*—

(1) *Requirement of Withholding.*—In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein: *Provided,* That if the liability assumed by the obligor does not exceed 2 per centum of the interest, then the deduction and withholding shall, after the date of the enactment of this Act, be at the following rates: (A) 5 per centum in the case of a nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or

place of business therein and composed in whole or in part of nonresident aliens, (B) 12 per centum in the case of such a foreign corporation, and (C) 2 per centum in the case of other individuals and partnerships: *Provided further,* That if the owners of such obligations are not known to the withholding agent the Commissioner may authorize such deduction and withholding to be at the rate of 2 per centum, or, if the liability assumed by the obligor does not exceed 2 per centum of the interest, then at the rate of 5 per centum.

(2) *Benefit of Credits Against Net Income.*—Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credits provided in section 25 (c) and (d); nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 215.

* * * * *

(d) *Income of recipient.*—Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

* * * * *

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file a return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, 25 per centum of the tax shall be added to the tax, except that when a return is filed after such

time and it is shown that the failure to file it was due to reasonable cause and not due to willful neglect no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

Section 291 of the Revenue Act of 1932, c. 209, 47 Stat. 169, is identical.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 143. WITHHOLDING OF TAX AT SOURCE.

(a) *Tax-Free Covenant Bonds.*—

(1) *Requirement of Withholding.*—In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, or a foreign corporation not engaged in trade or

business within the United States and not having any office or place of business therein: *Provided,* That if the liability assumed by the obligor does not exceed 2 per centum of the interest, then the deduction and withholding shall be at the following rates: (A) 8 per centum in the case of a nonresident alien individual; or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, (B) 13¾ per centum in the case of such a foreign corporation, and (C) 2 per centum in the case of other individuals and partnerships: *Provided further,* That if the owners of such obligations are not known to the withholding agent the Commissioner may authorize such deduction and withholding to be at the rate of 2 per centum, or, if the liability assumed by the obligor does not exceed 2 per centum of the interest, then at the rate of 8 per centum.

(2) *Benefit of Credits Against Net Income.*—Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credits provided in section 25 (c) and (d); nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 215.

* * * * *

(d) *Income of Recipient.*—Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be

credited against the amount of income tax as computed in such return.

* * * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

Art. 761. *Withholding tax at source.*—

* * * * *

Withholding of a tax of 2 per cent is required in the case of interest paid to an individual or a partnership, whether resident or nonresident (see article 1318), or to a nonresident foreign corporation upon bonds or other obligations of domestic corporations or resident foreign corporations (see article 1318) containing a tax-free covenant, except that if the liability assumed by the obligor in connection with such a covenant does not exceed 2 per cent of the interest, withholding is required at the rate of 8 per cent in the case of a nonresident alien or a nonresident partnership composed in whole or in part of nonresident alien individuals, and at the rate of 13¾ per cent in the case of a nonresident foreign corporation. However, withholding is not required in the case of interest payments on such bonds or obligations of a domestic or resident foreign corporation qualifying under section 119 (a) (1) (B), if made to a nonresident alien, to a partnership composed in whole of nonresident aliens, or to a nonresident foreign corporation. * * * If the owner of bonds or other obligations of a corporation containing a tax-free covenant is unknown to the withholding agent a tax of 2 per cent must be withheld from interest thereon unless the liability assumed by the obligor does not exceed 2 per cent of the interest, in which case withholding must be at the rate of 8 per cent.

* * * * *

Bonds issued under a trust deed containing a tax-free covenant are treated as if they contained such a covenant. * * *

* * * * *

Where in connection with the sale of its property, payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, or corporation, must deduct and withhold such taxes as would be required to be withheld by the assignor had no such sale or transfer been made.

* * * * *

In the case of corporate bonds or other obligations containing a tax-free covenant, the corporation paying a Federal tax, or any part of it, for someone else pursuant to its agreement is not entitled to deduct such payment from gross income on any ground, nor shall the tax so paid be included in the gross income of the bondholder. The amount of the tax may nevertheless be claimed by the bondholder as a credit against the total amount of tax due in accordance with section 143 (d). * * *

Art. 768. *Return and payment of tax withheld.*—Every withholding agent shall make on or before March 15 an annual return on Form 1013 of the tax withheld from interest on corporate bonds or other obligations. This return should be filed with the collector for the district in which the withholding agent is located. * * *

Art. 769. *Ownership certificates in the case of fiduciaries and joint owners.*—When fiduciaries have the control and custody of more than one estate or trust, and such estates and trusts have as assets bonds of corporations and other securities, a certificate of ownership shall be executed for each

estate or trust, regardless of the fact that the bonds are of the same issue. * * *

The corresponding articles of Treasury Regulations 74, promulgated under the Revenue Act of 1928, do not differ materially from the above-quoted regulations.

U. S. GOVERNMENT PRINTING OFFICE: 1942